FOR ARGUMENT

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In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-674

THIRD NATIONAL BANK IN NASHVILLE,
Petitioner,
vs.
IMPAC LIMITED, INC., et al.,
Respondents.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

PETITIONER'S REPLY BRIEF

THOMAS P. KANADAY, JR.
FARRIS, EVANS & WARFIELD
18th Floor, Third National Bank Building
Nashville, Tennessee 37219
Counsel for Petitioner

Of Counsel:
STEPHEN W. RAMP
FARRIS, EVANS & WARFIELD

E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, (816) 421-3030

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PETITIONER'S REPLY BRIEF

INTRODUCTION

The question before the Court is whether Section 91 of the National Bank Act, as interpreted by this Court, deprives state courts of jurisdiction to issue a temporary injunction restraining a national bank from foreclosing on its collateral. The Chancellor followed this Court's holdings in *Pacific National Bank of Boston* v. *Mixter*, 124 U.S. 721 (1888) and *Van Reed* v. *People's National*

Bank, 198 U.S. 554 (1905) and the policies articulated by this Court in *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963) and *Radzanower* v. *Touche, Ross & Co.*, 96 S.Ct. 1989 (1976) and dissolved the temporary injunction he had earlier issued against Petitioner.

The Supreme Court of Tennessee reversed the Chancellor on the ground that the statute does not mean what it appears to mean, and reinstated the injunction.

At no stage in the proceedings prior to the filing of Respondents' brief on the merits in this Court has the question of due process been briefed, argued, or even considered. Nor were any constitutional issues raised by Respondents' Brief in Opposition to the Petition for a Writ of Certiorari. Now, however, Respondents argue that the Chancellor's interpretation of Section 91 of the Act would deprive them of property without affording them due process of law. Their argument is premised on the erroneous assumption that, since *Sniadach* v. *Family Finance Corporation of Bay View*, 395 U.S. 337 (1969), and *Fuentes* v. *Shevin*, 407 U.S. 67 (1972), every debtor is entitled to a hearing before a creditor can exercise his rights against collateral.

Petitioner makes three responses to Respondents' eleventh hour constitutional attack on Section 91 and the Chancellor's interpretation of Section 91:

I. *This Is Not An Appropriate Case For A Review Of The Due Process Issue,*

II. *The Fifth and Fourteenth Amendments Have No Bearing On This Case,*

III. *12 U.S.C. § 91 Does Not Violate Respondents' Constitutional Guarantee Of Due Process Of Law.*

ARGUMENT

I. This is not an appropriate case for a review of the due process issue.

A. Constitutional issues raised for the first time in this Court will not be considered.

The Supreme Court has, on many occasions, declined to consider constitutional arguments raised for the first time on appeal. Hill v. California, 401 U.S. 797 (1971); Cardinale v. Louisiana, 394 U.S. 437 (1969); Nelson v. County of Los Angeles, 362 U.S. 1, 9 (1960); Wong Tai v. United States, 273 U.S. 77 (1927). In *Cardinale, supra,* Justice White explained: "The Court has consistently refused to decide federal constitutional issues raised here for the first time on review of state court decisions. . . . Questions not raised below are those on which the record is very likely to be inadequate, since it certainly was not compiled with those questions in mind." *Id.* at 438-39.

Similarly, in *Duignan* v. *United States*, 274 U.S. 196 (1927) Mr. Justice Stone refused to consider the constitutionality of the forfeiture of a leasehold under Section 23 of the National Prohibition Act because it was not raised in the trial court or in the assignment of errors.

In this case the record below is absolutely devoid of any consideration or analysis of the due process arguments now raised by Respondents. This Court should have the benefit of a complete record, considered briefs and the judgment of the courts below before it is called on to decide with finality questions of great import.

B. It is the sound policy of this Court to decide cases on grounds other than constitutional grounds whenever practicable.

It is well established that the Supreme Court seeks to avoid constitutional questions whenever a case can be decided on non-constitutional grounds. Alma Motor Company v. Timken-Detroit Axle Company, 329 U.S. 129 (1946).[1]

II. The Fifth and Fourteenth Amendments have no bearing on this case.

Petitioner submits that the posture of this case makes a consideration of Respondents' constitutional arguments unnecessary and ill-advised. However, if the Court chooses to address the constitutional issues, Petitioner argues that Respondents' invocation of the due process clause is spurious because there is no state or federal action in this case.

This case arises out of Petitioner's attempt to foreclose commercial property under a power of sale conferred by a deed of trust which secures Respondents' defaulted note. A number of lower federal courts have considered whether foreclosure under a power of sale is constitutionally sound. The cases addressing the issue overwhelmingly hold that foreclosure under a power of sale without a preforeclosure hearing does not violate the mortgagor's right to due process of law. In *Northrip* v. *Federal National Mortgage Association*, 527 F.2d 23 (6th Cir. 1975), *rev'g* 372 F.Supp. 594 (E.D. Mich. 1974), the mortgagors sued the mortgagee to set aside a foreclosure sale on the theory that the sale by the sheriff pursuant to a power of sale conferred

1. "This Court has said repeatedly that it ought not pass on the constitutionality of an act of Congress unless such adjudication is unavoidable." 329 U.S. at 136 (1946).

upon him in the mortgage, without a presale hearing, violated the mortgagors' right to due process under the Fifth and Fourteenth Amendments. The Court of Appeals for the Sixth Circuit, speaking through Judge McCree, found that the case "concerns a remedy privately created by contract" recognized at common law, and not governmental action against an individual. 527 F.2d at 28.[2]

> "The garnishment (in *Sniadach*) and replevin (in *Fuentes*) did not depend upon a contractual power granted to the creditor as is the case here. Instead, any person could invoke the aid of the state with no more than a bare assertion that money was owed him." 527 F.2d at 28.

In *Barrera* v. *Security Building & Investment Corporation*, 519 F.2d 1166 (5th Cir. 1975) individuals who had lost their house and lot in a non-judicial foreclosure under a power of sale contained in a deed of trust unsuccessfully sued for damages and for a declaratory judgment that the Texas statute governing foreclosures failed to meet minimum standards of due process under the Fourteenth Amendment. The Court of Appeals for the Fifth Circuit, speaking through Judge Wisdom, in a carefully reasoned opinion, found that there was not a sufficiently close nexus between the state and the challenged action to give rise to a Fourteenth Amendment claim:[3]

2. "The power is part of the contract, and should be construed on principles applicable to contracts, and not as a hostile process." 527 F.2d at 27. The Court also analyzed and rejected plaintiffs' assertion that federal action was present since the mortgagee, FNMA, was created by Congress in the National Housing Act of 1968, 12 U.S.C. § 1716 (1970).

3. "The state has not cast the weight of its approval behind the practice challenged here. It has merely stayed its hand. . . . No such nexus is evident here. The regulation cited by the appellants does not betray a state partnership in the challenged activity or the kind of symbiotic relationship that would permit us to impute to the state the responsibility for the challenged conduct." 519 F.2d at 1172.

"First, there is no direct involvement of the state in the act complained of here. No state official or agency participated in the creation of the power of sale, in the decision to exercise that power, or in the actual exercise of that power. At no time did the seller seek or rely on the aid of any arm or agent of the state. This absence of direct state involvement in the act by which the deprivation itself was accomplished sets this case apart from *Fuentes* v. *Shevin*, 1972, 407 U.S. 67, 92 S.Ct. 1983, 32 L.Ed.2d 556; *D. H. Overmyer Co.* v. *Frick Co.*, 1972, 405 U.S. 174, 92 S.Ct. 775, 31 L.Ed.2d 124; *Swarb* v. *Lennox*, 1972, 405 U.S. 191, 92 S.Ct. 767, 31 L.Ed.2d 138; *Sniadach* v. *Family Finance Corporation*, 1969, 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed.2d 349.

A sale under a deed of trust, to be an effective creditor remedy, must of course pass good title. The contract that provides for a power of sale thus relies, ultimately, on the state's acknowledgment of the legal effect of the involuntary change in ownership brought about by the exercise of the power of sale. That the state merely recognizes the legal effect of such private arrangements does not convert them into state acts for Fourteenth Amendment purposes. See *Black* v. *Cutter Laboratories*, 1955, 351 U.S. 292, 76 S.Ct. 824, 100 L.Ed. 1188. This principle is implicit in our UCC cases. It is explicit in the decisions of other circuits holding that a secured party, to enable it to sell an automobile repossessed through self-help, and permitting the sale to convey good title, does not significantly implicate the state in the termination of the debtor's property interest. See, e.g. *Shirley* v. *State National Bank of Connecticut*, 2 Cir. 1974, 493 F.2d 739, 743 n. 5; *Gibbs* v. *Titelman*, 3 Cir. 1974, 502

F.2d 1107. Virtually all formal private arrangements assume, at some point, the supportive role of the state. To hold that the state, by recognizing the legal effect of those arrangements, converts them into state acts for constitutional purposes would effectively erase to a significant extent the constitutional line between private and state action and subject to judicial scrutiny under the Fourteenth Amendment virtually all private arrangements that purport to have binding legal effect.

Here, by contrast, no state statute creates a right in mortgagees to proceed by non-judicial foreclosure; the right is created by contract. Moreover, the action taken by the appellee cannot be described as a function that has been traditionally the exclusive prerogative of the state.

Non-judicial foreclosure under a power of sale can certainly be characterized as a traditional remedy. Although it is not entirely clear when powers of sale first came into use in this country, they were sufficiently commonplace in 1774 to prompt New York to enact a statute to regulate their use. G. E. Osborne, Handbook on the Law of Mortgages, 726 (2d ed. 1970). In 1828 a New York Court described the power of sale as 'as ancient as the formation of the English government in this state.' *Slee* v. *President, et al. Manhattan Co.*, N.Y. 1828, 1 Paige 48, cited in Osborne at 729, n. 12. In Texas, non-judicial foreclosure under a power of sale in a deed of trust has been used and recognized for over one hundred years. *See*, for example, *Hipp* v. *Hutchett*, Tex. 1849, 4 Tex. 20, 25. Courts in the United States consistently recognized these powers of sale as valid and enforceable. Justice Field, speaking for the Supreme Court, held, in 1895:

> 'There is nothing in the law of mortgages, nor in the law that covers what are sometime designated as trust deeds in the nature of mortgages, which prevents the conferring by the grantor or mortgagor in such instrument of the power to sell the premises described therein upon default in payment of the debt secured by it, and, if the sale is conducted in accordance with the terms of the power, the title to the premises granted by way of security passes to the purchaser upon its consummation by a conveyance.'

Bell Silver & Copper Mining Co. v. *First National Bank*, 1895, 156 U.S. 470, 477, 15 S.Ct. 440, 443, 39 L.Ed. 497, 501. Somewhat later the Court noted that '[t]he validity of such a contractual power of sale is unquestionable.' *Scott* v. *Paisley*, 1926, 271 U.S. 632, 635, 46 S.Ct. 591, 592, 70 L.Ed. 1123, 1125. Professor Durfee could, in fact, find only a single instance of judicial nullification of a power of sale. Durfee, Cases Mortgages 355 n. 23, cited in Osborne at 726 n. 11.

Certainly, it cannot be said that termination of a debtor's equity of redemption was ever, in this country, the exclusive prerogative of the state. Foreclosure of the equity of redemption under contractual powers of sale have paralleled the foreclosure remedies provided by the courts. That the state has also involved itself in foreclosure practices, by providing first strict foreclosure and then later foreclosure by judicial sale, does not make the parallel private remedy state action. We agree with Judge Friendly in rejecting the notion that 'the state can constitutionally allow private persons to offer services parallel to those it offers or could offer only if it requires them to conform to

the same standards the Fourteenth Amendment imposes upon it.' The Dartmouth College Case and the Public-Private Penumbra at 24. The Supreme Court, in *Evans* v. *Newton*, expressly disavowed any such interpretation of its 'public function' holdings:

> 'The range of governmental activities is broad and varied, and the fact that the government has engaged in a particular activity does not necessarily mean that an individual entrepreneur or manager of the same kind of undertaking suffers the same constitutional inhibitions.' 382 U.S. 296, 300, 86 S.Ct. 486, 489, 15 L.Ed.2d 373.

Finally, as noted, this Court found no state action in self-help possession, even though self-help is clearly a remedy parallel and alternative to available judicial remedies.

* * *

> Indeed, self-help repossession, when measured against the transfer of title accomplished through non-judicial sale, strikes us as bearing more of the earmarks of the force the.exercise of which is traditionally confined to the sovereign, than does the transfer of title accomplished through a non-judicial foreclosure rule." 519 F.2d at 1170, 1172-73.

In *Bryant* v. *Jefferson Federal Savings and Loan Ass'n*, 509 F.2d 511 (D.C. Cir. 1974), the Court held that plaintiff's claim that the non-judicial foreclosure procedures of the District of Columbia were violative of the due process clause of the Fifth Amendment was "insubstantial" and did not require a three-judge court.

> The due process clause is a limitation on governmental, not private, action. *See, e.g.*, Moose Lodge No. 107 v. Irvis, 407 U.S. 163, 172, 92 S.Ct. 1965, 32

L.Ed.2d 627 (1972); Shelley v. Kraemer, 334 U.S. 1, 13, 68 S.Ct. 836, 92 L.Ed. 1161 (1948). Thus, appellants must establish "significant government involvement" in order for the challenged action to fall within the ambit of the constitutional protection. *See* Moose Lodge v. Irvis, *supra*, 407 U.S. at 173, 92 S.Ct. 1965; Reitman v. Mulkey, 387 U.S. 369, 380, 87 S.Ct. 1627, 18 L.Ed.2d 830 (1967).

There is no significant governmental involvement in the mortgage foreclosure practices attacked here. The power of sale was created, not through governmental enactment, but by private consensual agreement. We recognized long ago that a deed of trust "provides the remedies for its own enforcement." 509 F.2d at 513.

In *Lawson* v. *Smith*, 402 F.Supp. 851 (N.D. Cal. 1975) plaintiffs sued to set aside a trustee's deed issued pursuant to a non-judicial foreclosure sale on the ground that the deed was void because the statutory provisions governing foreclosure sales in California are unconstitutional under the due process clause of both the Federal and State Constitutions. As in *Bryant* v. *Jefferson Federal Savings and Loan Ass'n, supra,* the Court found no governmental action and dismissed the case.

In *Global Industries* v. *Harris*, 376 F.Supp. 1379 (N.D. Ga. 1974) the Court held that the Georgia Statute regulating foreclosure sales under powers contained in security deeds did not provide the requisite state action on which to predicate a claim under the due process clause of the Fourteenth Amendment inasmuch as the creditor's power of sale was derived from the parties' contractual undertaking rather than from the Statute.

As Judge Wisdom noted in *Barrera, supra,* the case law developed under the self-help provisions of the Uniform Commercial Code overwhelmingly supports the conclusion that a creditor's remedy created by private contract and privately enforced is not susceptible of constitutional attack. *See, e.g.,* Shirley v. State National Bank of Connecticut, 493 F.2d 739 (2nd Cir.) *cert. denied* 419 U.S. 1009 (1974); Gibbs v. Titelman, 502 F.2d 1107 (3rd Cir. 1974); James v. Pinnix, 495 F.2d 206 (5th Cir. 1974) (no Civil Rights Act violation); Turner v. Impala Motors, 503 F.2d 607 (6th Cir. 1974); Bichel Optical Laboratories, Inc. v. Marquette National Bank of Minneapolis, 487 F.2d 906 (8th Cir. 1973); Adams v. Southern California First National Bank, 492 F.2d 324 (9th Cir.), *cert. denied* 419 U.S. 1006 (1974).

The decisions of the federal district courts and state courts upholding the constitutionality of self-help are legion. *See, e.g.,* Greene v. First National Exchange Bank of Virginia, 348 F.Supp. 672 (W.D. Va. 1972); Pease v. Havelock National Bank, 351 F.Supp. 118 (D. Neb. 1972); McCormick v. First National Bank of Miami, 322 F.Supp. 604 (S.D. Fla. 1971); Kinch v. Chrysler Credit Corp., 367 F.Supp. 436 (E.D. Tenn. 1973); Woods v. State of Tennessee, 378 F.Supp. 1364 (W.D. Tenn. 1974); Shelton v. General Electric Credit Corp., 359 F.Supp. 1079 (M.D. Ga. 1973).

The foreclosure proceeding in this case follows the pattern described in *Northrip* and *Barrera, supra.* The State of Tennessee and the Congress of the United States have no involvement in the foreclosure sale or transfer of title from the Trustee to a purchaser at the foreclosure sale. Appellants appear to argue that the application of Section 91 of the National Bank Act according to its plain meaning would render Section 91 violative of the due process clause of the Fifth Amendment. However, the

enactment and operation of Section 91 involves exactly the same governmental function at the federal level as the enactment of the self-help provisions found in Article 9, Section 503 of the Uniform Commercial Code by the various states. In neither instance is the nexus between governmental action and the act complained of sufficiently close to give rise to a governmental violation of due process.

III. 12 U.S.C. § 91 does not violate Respondents' constitutional guarantee of due process of law.

Even if the Court finds that Section 91 of the National Bank Act sufficiently draws the federal government into the foreclosure process to give rise to a colorable due process issue, the facts in this case show that there has been no violation of Respondents' right to due process.

A. A meaningful hearing is available.

Respondents argue that their inability to obtain a temporary injunction restraining the foreclosure sale by reason of Section 91 deprives them of a hearing. This is obviously erroneous. Nothing in Section 91 deprives mortgagors of a prejudgment hearing. Section 91 merely denies state courts the power to grant *certain types of remedies*.

Nothing in Section 91 prevents a mortgagor from filing a preforeclosure complaint seeking declaratory relief or obtaining a show cause hearing prior to the sale in which the Court could a) advise the mortgagee that it appears likely that a foreclosure sale, if conducted, would be set aside based on the showing made by mortgagors, and/or b) enter an order that the sale will be subject to the further orders of the Court. Under these circumstances, a national bank-mortgagee would be forced to proceed at its peril. In addition, any purchaser from the Trustee would take title subject to the sale's being set aside or deemed improper.

Secondly, immediately upon consummation of the sale the mortgagors could seek to set the sale aside. Since, under Tennessee law, the purchaser takes only such title as the Trustee owns, the property cannot be transferred to one having the rights of a bona fide purchaser. And, unlike the personalty in *Fuentes* v. *Shevin, supra,* real property stays put during the litigation. Moreover, under Tennessee law, the standard of proof for setting aside a foreclosure sale is identical to that required for preforeclosure injunctive relief. Held v. Tennessee Title Company, 223 Tenn. 545, 448 S.W.2d 413 (1969). Consequently, if a mortgagor were able to persuade the Court to enjoin the foreclosure in advance, he should have no difficulty persuading the Court to set aside the sale, and, presumably, to award damages for wrongful foreclosure.

Thus, although Section 91, by its terms, denies a particular type of remedy at a particular stage of the litigation—a temporary injunction—it does not deny mortgagors of a meaningful hearing or other types of relief that would adequately protect their property rights. Accordingly, the correct application of Section 91 does not violate the due process clause of the Fifth Amendment.

B. Respondents have waived any constitutional defenses.

Even if these Respondents once had a colorable due process argument, their failure to assert it earlier in these proceedings constitutes a waiver of that right.

> As this Court has noted, "even constitutional objections may be waived by a failure to raise them at a proper time. . . ." *Curtis Publishing Co.* v. *Butts,* 388 U.S. 130, 143 (1967). "No procedural principle is more familiar to this Court than that a constitutional right may be forefeited in criminal as well as civil